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DOMESTIC AND INTERNATIONAL COMMODITY POLICY - THE LINK BETWEEN ECONOMIC AND POLITICAL REALITIES

INTRODUCTION

My government position carries the title Assistant Secretary for International Affairs and Commodity Programs. This may look like an odd, perhaps incompatible, combination of jobs, but in fact, this portfolio reflects the realities of the domestic commodity markets and the international programs that are the prime focus of the Department of Agriculture.

Part of this reality is expressed in the fact that for the past several weeks this Administration has been engaged simultaneously in domestic and international food policy decisions. Together with Congress, we have been rewriting domestic commodity legislation, including the price support programs for all major commodities the United States exports, plus Public Law 480, the Food for Peace Program. At the same time, we began serious negotiations for international commodity arrangements in sugar and wheat, and we continue to be engaged in multilateral and bilateral trade negotiations in Geneva and elsewhere. In addition, during the same short period of time, the Secretary of Agriculture led the U.S. delegation to the World Food Council, the 36-member body of the United Nations that deals with major concerns about the food problems facing developing countries at present and in the future.

Remarks by Dale E. Hathaway, Assistant Secretary for International Affairs and Commodity Programs, delivered by Dr. Larry Witt, before the International Committee Dinner meeting of the American Agricultural Economics Association, San Diego, California, August 1, 1977

Tonight I want to talk about my perceptions, both domestic and international, of the major economic and political realities that determine the content of this combination of domestic and international commodity programs.

I

Let me begin with some of the economic realities. During this decade we have moved from chronic surplus in world grain production to a shortfall relative to a rising demand, and again into a surplus situation, with wide price changes. Let us look at the statistics of the past few years in more detail.

What we find is both marked growth and increased volatility in world food production--particularly world grain production--and supplies. World food production and supplies had grown at a relatively stable pace approaching 3 percent per year through most of the 1960's. Production in 1972 and again in 1974 proved quite disappointing; grain harvests fell more than 2 percent and 2.5 percent below the trend of the last decade and a half, respectively. The jump in world import demand generated by these two years of shortfall combined with population and income-growth-related increases in import demand forced the major exporters to draw stocks down to record lows. By the beginning of 1975, world stocks had fallen below 10 percent of annual consumption, compared with over 19 percent as recently as 1969. Production recovered in 1975, and 1976 crops set new records; reports to date indicate another year of record harvests is possible in 1977. Stocks accumulated by

the beginning of the 1977/78 season were large enough to push world reserves up to 15 percent of annual consumption, and raised available supplies for use through the current year to a new all-time high.

Increased growth and volatility in production have been even more marked in several regions of the world. Soviet production--accounting for some 15 percent of the world total--set new records in 1973 and 1976, but recorded a severe shortfall in 1975. The Soviet decision in 1972 to play an active role in the world market translated these fluctuations in production directly into variations in world import demand and export availabilities. Variations in North American production have been appreciably smaller but no less significant due to the role played by the United States and Canada in international trade. Variations in a number of developing countries also have been important in determining world supplies. South Asia in particular faced marked increases in production early in the decade, disappointing harvests in 1972 and 1974, and bumper harvests in 1975 and 1976.

Wheat prices have fallen from $5.82 at their June high of 1974 to $2.31 per bushel in June 1977, while corn prices have fallen from the October 1974 high of $3.74 to the June 1977 price of $2.27 per bushel. In real terms, the decline is even more severe; the current wheat price in real terms is less than one-third and the corn price is about one-half of the peak levels reached in 1974. Actually, the price of wheat, in real terms, is only slightly higher than in June 1972, although corn prices are still about 25 percent better than in 1972.

But if we look at the other side of the equation that helps determine prices, we find that the world has not yet fully recovered from the substantial lag in growth in food consumption that began in 1972. This lag was induced first by a marked slowdown in economic growth rates in both the developed and developing countries, and compounded by the shock of rising petroleum prices. Consumption in many of the poorer countries has been reduced or held at relatively low levels because they face the necessity of supporting prices at much higher levels in order to cover higher costs of production and deliver the necessary producer incentives.

In particular, despite sharply lower grain prices and larger world production, per capita production and per capita consumption rates in the bulk of the LDCs have only recovered to the 1969-71 levels, so that the previously existing, gradual improvements have been halted. In important sections of the developing world, mainly in Africa, consumption levels are still below those of 1969-71.

Thus, we again face, for much of the world's population, a substantial problem of inadequate food supplies, combined with what are clearly seriously depressed and inadequate prices for many of the producers in the major grain exporting countries. That is economic reality No. 1.

The second economic reality is that the world is beset with agricultural income and trade policies which are designed to reduce changes in supply and demand. We are all aware of the general inflexibility and lack of use of pricing in the centrally-planned economies. But in many other major economies throughout the world, various types of intervention also create systems that

do not allow adjustment to world supply and demand changes because internal prices are maintained at stable levels. As a result, the impact is magnified in those relatively open economies like that of the United States. The impact hurts most those who adjust to world conditions by allowing price adjustments to influence both supply and demand. Equally hurt are those who are substantial net importers but are priced out of the market by sharp price increases because they lack foreign exchange for external purchases, or lack sufficient personal purchasing power even if the grain is available within the country.

A third economic reality is that the inelastic demand, especially for wheat for food, results in a narrow margin between having too little and too much of a product. Very wide and rapid swings in prices occur with relatively small changes in production, particularly in exporting countries. Even though the volume of world grain trade has risen by nearly 50 percent in the past decade, it is still only 12 to 14 percent of total world consumption. And despite huge advances in science and technology and an expansion in irrigation, much of the world's grain production is still subject to the impact of weather. Thus, price instability on the world market is still a major problem in the world system, both to importing and exporting countries, creating serious problems of differing magnitudes but stemming from the same economic characteristics.

II

I turn now to some of the political realities. The events of 1972 through 1975 brought food into the international arena as a major political issue. In the U.S. the consumer price index for food, with a 3-year

increase of 42 percent, was rising faster than the overall CPI, illustrating that indeed food price inflation could be a major destabilizing influence on our U.S. economic system. Beyond their initial contribution to overall living costs, higher food prices on a second go-round have contributed to higher wages, through cost escalator clauses tied to the Consumer Price Index, and to higher cost of government programs also tied to the CPI, for example, food stamps, social security, and retirement programs. In many food deficit countries, including India and Bangladesh, the prices of imported staples rose even more dramatically, causing severe hardships. (Their food prices rose 65 percent and 103 percent respectively.) Only a few countries, like EC-9 members, succeeded in insulating their markets from world price fluctuations through price protection policies, albeit with substantially higher consumer food prices. West Germany, for example, experienced only an 18 percent increase in food prices--also a smaller increase than its overall CPI. France, Belgium and the Netherlands, likewise, restrained the increase in food prices.

It has become clear that major, and sometimes irrational, movements in world food prices, both up and down, can and do threaten the economic and political stability of nations. Thus, political interest in food and food prices at home and abroad is nearly as high as that during the food crisis of 1972-74. Moreover, so far as most of the countries of the world are concerned, the possibilities of more 1972-74 periods are still real. Most of the world's excess supplies lie either in the centrally planned economies or in North America, and many countries feel they have no guarantee that these supplies will be held in reserve to protect against a recurrence of the recent past.

Also, unlike earlier periods, we are engaged in various fora in what is known as a North-South dialogue. This is of considerable importance because certainly two of the greatest disparities between North and South are the differences in the quantity of food consumed and in the stability of food supplies. Increasingly, both here and in other countries, food is being viewed as one of the basic human rights; thus, any denial of food or the failure of the system to guarantee certain basic minimums becomes a significant issue in the continuing North-South dialogue.

Putting these all together, one comes to a political reality that there is a link between price stability and trade liberalization. Many of my learned colleagues have correctly pointed out that the rather modest changes in the world food production, if distributed equitably around the world in a system of free trade completely devoid of mechanisms that have reduced adjustment, would provide a world system with relatively little instability. Despite rather substantial swings in food production levels in individual countries, small price changes and trade would bring adjustment. It is, however, totally unrealistic, given the political sensitivity of food, to assume that any substantial trade liberalization can be attained without substantial assurance to those participating in such liberalization that there will be some stabilization of major food markets, both for producers and consumers. In major importing nations, the pressures to support high-cost, inefficient agriculture seem likely to continue to receive reinforcement from consumer groups unless the latter can be assured of some stability of supply and some reasonable stability in the price of imports. They need to feel certain that their required food supplies will be available under

a trading system. Therefore, I submit that trade liberalization cannot be achieved without simultaneously, for some products, and especially the major grain products, providing a greater degree of stability in world markets than has been the case for many of these products in recent years.

A final political reality: For a variety of reasons relating to the slowdown in economic activity, U.S. agriculture is one of the few remaining forces in the world pressing for trade liberalization. Thus, for the United States, there cannot be a successful trade negotiation without appreciable success toward liberalization of trade in agricultural products. It is not necessary to explain these political dynamics to this audience. It is important, however, to point out that in other countries agricultural issues also affect the acceptability of trade policy decisions. Despite the protectionistic tendencies noted earlier, for many countries successful trade liberalization must include actions that provide a measure of market stability for agricultural products.

III

Now let us turn to some practical problems that grow out of these complex economic and political realities. The first practical problem is that the political forces that come into play and are a crucial element in domestic farm legislation are not the same as those involved in stabilization discussions; nor are they the same political forces that are concerned with trade liberalization. The same comment applies to the European Community, but with less force, and many other countries; pricing, stabilization, and trade liberalization involve different coalitions of political forces.

Moreover, the situation becomes more complex because different countries and groups of countries have different interests in the various subjects and several commodities.

Let me cite an example: In the case of wheat, in 1976-77 the major importers of wheat happen to be divided approximately 56-44 percent between the developing and the developed countries, the latter including Eastern Europe and the USSR. As mentioned earlier, developing countries have special problems with supply and price instability for their exports, and, thus, in price stabilization. For imported products crucial in their diets, developing countries seek to limit price increases, but they are mainly concerned with price floors for the major agricultural products they export. In the late-spring international sugar negotiations, the LDCs were not very sympathetic to measures to provide protection to consumers in importing countries.

On the other hand, developed countries that are major producers and consumers of wheat have sufficient resources and flexibilities to withstand fluctuations in price and supply, so have less interest in limiting price increases. For coarse grains, of which more than 80 percent are produced and consumed in developed countries, livestock producers and urban consumers have a major interest in stabilization, while the grain producers give major support to trade liberalization. For sugar, all importers have a domestic sugar industry, a factor that keeps any country from taking a purely consumer position in international trade policy discussions.

Because of these differences, different sets of interests apply between the two groups of countries and among commodities in the discussion of price policy, stabilization measures, and trade liberalization.

I am certain there are many who will question whether, despite my earlier assertions, the relationship of domestic commodity programs and international relations are appropriately reflected in what this Administration has been attempting to do. I would like to be able to say that everything that we have suggested or achieved is perfect and totally consistent. To do so, however, would be either an attempt to mislead you or an indication that I may be misleading myself. We do think, however, that we can claim a substantial amount of consistency.

First, this Administration has from the outset proposed a domestic price and income support program for the major traded products that would keep them competitive in world markets while attempting to protect the producers' incomes via the use of a target price mechanism. We are not ignoring the fact that, for several important world-traded agricultural commodities, current price levels are approaching the cost of production even for the efficient producers. This means they are at or below the prices necessary to provide incentives to producers in many countries which need extra production, for instance, in items such as sugar. Thus, our domestic price and income support program has essentially been oriented toward an international market and, more importantly, toward an international market into which we seek to build a greater element of stability.

On the issue of stabilization, the U.S. is actively seeking solutions in appropriate fora, and our active and concerned participation in the discussions of a new international sugar agreement is a good example. In the sugar discussions, we have to reflect both the concerns of domestic producers and those of consumers in the world's major importing countries. We seek to add stabilization elements that will protect the producers of our own and other countries from very low prices. We also seek devices to protect the major importing consumer countries, like our own, from the extraordinarily high prices that could result as a producer over-reaction to the current low prices. We approach the forthcoming negotiations on wheat in roughly the same manner. We recognize that stabilization has to be an important element but insist that price and production adjustments also must be included to complement a stock mechanism. These three measures are needed both to protect importing countries and to deal effectively with the adverse effect of production that cannot be absorbed at satisfactory prices in domestic or world markets.

Third, we are involved in a substantial number of trade negotiations, especially in multilateral trade negotiations in Geneva. Basically here, our approach has been that trade negotiations should include not only what is generally called liberalization, but also should avoid the use of mechanisms that both impede or disrupt trade and create serious problems of destabilization for others by transferring instability through these mechanisms.

Fourth, we, of course, have to recognize that there are certain product complexities in all of these matters. In many countries of the

world, but not in all, it is possible to substitute much wheat for feed grains at the appropriate price ratios. Thus, the process of stabilization may affect more than one product and, moreover, stabilization agreements in one area may affect either trade liberalization or market expansion in another area.

IV

I have mentioned only a few of what I consider to be the economic realities, the political realities, and the complexities that arise from them in the development and implementation of domestic and international commodity policy. Finally, let me say a few things about my view of the world ahead.

Basically, it seems to me that there is some reason for optimism. As I mentioned earlier, enough individuals and enough governments are conscious of the recent difficulties so that I believe there exists a genuine desire for movement on several of the issues I have mentioned. However, I do not expect to reach a perfect world, because one of the practical realities is that the currents of economic pressures often work at cross purposes. Pressures that push for a workable international agreement on sugar or wheat also lead toward actions that could have substantial effects in reducing the prospects for trade liberalization and an improved trading world. The realities are that extreme income pressure on domestic producers in the United States or any country generally creates demands for domestic programs to push up prices rather than a review of the problem in a broader context. In most cases, the proposed price levels, while

producing reasonably satisfactory income to producers, would almost certainly disrupt the prospects of expanding exports and liberalizing trade and, of course, in all likelihood, the chances for any reasonable stabilization agreements.

Thus, the same political forces that press for some kind of commodity action when supplies are adequate and prices are falling are often the same forces that make it more difficult to deal with a certain future problem of substantially rising prices and diminished supplies. The events of the recent past have been etched sharply in the memories of many; the fact that these points are still remembered may be helpful. But time is rapidly running out; unless we can have substantial momentum on these issues within the next twelve to eighteen months, we will have missed a golden opportunity to relate substantially our domestic commodity policy with improved world stabiliation and trading programs.
